The Seen and the Unseen: Economics in One Lesson
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Henry Hazlitt has written a very interesting and useful book that explains how economic analysis should be applied to various political economic topics. The title of the book is: Economics in One Lesson. In reading the book, I was struck by how much of it was an update of Bastiat's Essay: "What Is Seen and What Is Not Seen." Bastiat, however, died in 1850 so all of his essays were written prior to that date. Unfortunately, while his analysis is correct, the fact that his analysis is ignored by politicians, reflects the fact that their self-interest often makes them disregard valid economic analysis. In this essay, therefore, I will first mention Hazlitt's main lesson and then I will go into more detail on the topics that Bastiat and Hazlitt have considered.

To begin, let me cite a famous quote by Milton Friedman, a Noble Prize winning economist. Friedman said, "There is no such thing as a free lunch." What he meant by that is that if a person consumes resources (lunch) then those resources must have been produced by someone. The production process undoubtedly required labor time as well as various valuable resources that could have been used for some other purposes. While the consumer may not have paid directly for his or her lunch, the required resources to make lunch are gone and lost forever, and are no longer available for alternative use—thus there is an "opportunity cost" to the economy when resources are used for one purpose rather than another.

The main lesson in Hazlitt's book is that everything has an "opportunity cost." Thus, when any government spends, taxes, conscripts labor, or enters into any other economic transaction, there will be an opportunity cost to society that must also be considered before the net benefits (if any) of governmental activity can be assessed. Too often, however, governments are blind to the opportunity costs of their activities. Hazlitt gives many examples, most of which were previously addressed by Bastiat—a French Economist, Journalist, and Legislator—prior to 1850.

The date for Bastiat's writings is no mistake, Bastiat died in 1850, almost 170 years ago. What is distressing is that politicians have seemingly learned little about economics ever since. In my essay on Monopoly and Government: Enemies of Free Markets, I lay the groundwork for explaining why governmental administrators and politicians often choose to ignore economic realities—they may have a vested interest in doing so. The reason is that concentrated gains for people or industries who may benefit from a government action are often more visible than the potential losses for, possibly a vastly greater number, who will each lose a much smaller or harder to perceive amount.

The main objective of Bastiat's important essay: "What Is Seen and What Is Not Seen," is to point out the opportunity costs of various public policies that governments frequently pursue. I will discuss many of their most important points that Bastiat and, later, Hazlitt, make.

Bastiat starts by differentiating between "bad" economists and "good" economists. He notes that bad economists only see the obvious first visible effect of a policy, or what is "seen.". Good economists, in contrast, look at what is likely to happen as a "foreseen" consequence of a policy. He notes that learning since birth, either through experience or foresight, enables one to anticipate possible adverse effects of a policy. In the personal realm, shortsighted people may only look at personal satisfaction. Thus, they may engage in "debauchery, sloth, or prodigality." Foresighted people anticipate the potential future adverse effects of such behavior and exercise forbearance, work effort, or thrift. Thus, Bastiat differentiates between bad and good economists based upon their ability to foresee the future consequences of their proposed actions.

Personal note: What Bastiat has observed is a common failing of human nature. Unfortunately, most people are short-sighted and cannot control their desires for immediate satisfaction very well. Thus, they fall prey to their impulses or to the blandishments of demagogues (such as unscrupulous politicians or political parties). Throughout his essay Bastiat points out the arguments made by such short-sighted legislators in his day and refutes their arguments by pointing out the future implications of their proposed actions. In my life I first noted the improvident short-sighted nature of most people when I worked at the Federal Reserve and had access to aggregate credit card data. The data showed that less than one-third of the people paid off their monthly credit card bills in full, even though credit card interest rates were many times the rate that they could earn on personal savings or would have to pay on other consumer loans. Thus, I concluded that many people were financially short-sighted.

Further evidence of the fact that most people are short-sighted comes from the "marshmallow" experiments, first conducted by a psychologist at Stanford University. In the experiment, preschoolers were shown a marshmallow and were told that if they didn't eat it they would get two marshmallows when the experimenter returned to the room after running needed errands that would take about 15 minutes. Only one-quarter, or slightly more, of the preschoolers were able to resist temptation for the full 15 minutes. Later, when his own children were older, the Stanford psychiatrist noted that his children and the others who had resisted temptation in the experiments seemed to do better in school, have fewer drug and other personal discipline problems, and even did better on SAT tests for college than those who had succumbed to temptation. At first, these observations were casual, but he followed up by systematically trying to trace all the students who had taken part in the experiments and the casual observations were confirmed. Subsequently, these experiments were replicated in other cultures and environments and with other ages and incentives and the results seemed to be similar—in most cases only one-quarter to one-third of the participants exercised forbearance. Thus, I conclude that only one-quarter to one-third of the population is sufficiently foresighted to resist short-term temptations—particularly when financial considerations are involved.

The short-sighted nature of most people is why they tend to fall prey to the "bad" economic arguments and blandishments of the politicians whose arguments Bastiat refutes in his essays. More worryingly, it is why political parties and related demagogues can be successful by appealing to short-sighted and uninformed people who either cannot foresee the consequences of potential economic policies or don't care about possible adverse consequences because their short-sighted nature makes them focus upon promises of immediate gratification. Such political parties often focus on getting their short-sighted potential voters to the polls. They favor "motor-voter" policies, on the spot-registration versus pre-voting registration requirements, and no photo or other ID requirements. If such politicians have their way, the voting population will be biased toward short-sighted people and away from those (the minority) who try to foresee future implications of potential economic policies. As a result, politicians will be elected who appeal to short-sighted people and all of Bastiat's arguments will be for naught.

Back to Bastiat

Bastiat's paper, "What Is Seen and What Is Not Seen" covers a number of topics that were politically important and contentious in his day (late-1840's France), most of which are still relevant due to the tendency of demagogues to make the same arguments now as they did in his day. They include:

The Broken Window

The Demobilization

Taxes
Theaters and Fine Arts
Public Works
The Middleman
Restraint of Trade
Machines
Credit
Algeria
Thrift and Luxury
The Right to Employment and the Right to Profit

THE BROKEN WINDW FALLACY

Possibly the best known component of Bastiat's essay is "The Broken Window Fallacy." That component, in essence, repudiates many of the "Keynesian" economic stimulus policies that governments like to pursue. I first came across this essay after "Hurricane Sandy" devastated the U.S. East Coast. Many people cited the devastation that had occurred but said it would ultimately be good for the economy. Its beneficial effects would come from all the spending made, and (presumably) financed by the government that would have beneficial "multiplier" effects upon the economy. Supposedly these beneficial multiplier effects would result from the fact that people and businesses that provided labor and materials to the (government financed) rebuilding effort would use their increased income to buy more goods and services, etc. This is similar to the economic stimulus benefits claimed by people in Bastiat's day in the event that someone was to suffer a broken window and have to replace it. They argued that repairing the window would provide work for the glazier, who in turn would buy more goods and thereby further stimulate the economy. Bastiat, however, pointed out that had the window not been broken, the owner of the property would still have the money that he used to repair the window. He might use that money to buy new clothes or shoes and the sellers of those goods would have those funds to spend which also would further stimulate the economy. In addition, the owner of the property would not only have new clothes but would still have a window as well. The key, here, is that Bastiat assumed that the amount of money was limited so if the owner of the window spent it on a new window, he could not spend it on something else.

Present day Keynesian arguments assume that the money supply is not fixed since we no longer use hard money whose quantity cannot be increased easily. However, in the absence of a liquidity trap, increases in the fiat money supply are likely to cause increases in total spending and future inflation, which the foresighted may foresee. Nonetheless, some Keynesians believe that, at times, the economy may have so much money that it could be in a liquidity trap in which the government can borrow without increasing interest rates and causing other expenditures to be cut back. Keynesians assume that government financing can be achieved with debt issuance, rather than by taxing other people to obtain spendable funds as Bastiat assumed. Nonetheless, resources given to the government in exchange for debt are still resources that cannot be spent to buy other things as spendable funds are transferred from private hands to the government. However, if the debt is sold to foreigners, the debt can be financed without causing reductions in current domestic spending Unfortunately, that debt must be repaid and that will potentially cause a reduction in future domestic spending—which the foresighted are concerned about, when they mention the burden that such debts may place upon their children or grandchildren. Overall. While Bastiat's arguments are valid, foreign financing of debts allows short-sighted people to avoid the offsetting immediate sacrifice in domestic spending that otherwise would occur.

DEMOBILIZATION

Demobilization was an argument made in Bastiat's time in which politicians argued that downsizing the military would lead to unemployment and depress total spending in the economy—possibly with multiplier effects. Bastiat countered this argument by noting that the soldiers had opportunity costs associated with being in the military and many of them might be able to be employed more productively if they were able to devote their time to its most productive uses rather than remain idle in the military when their service was no longer needed. In fact, he argued that it was likely that the economy would thrive if they were freed up to use their time as productively as possible.

Personal Note: Similar arguments were made by "shortsighted" Keynesian economists after WWII as they expected a severe recession might occur when the troops were demobilized. However, after only a minor period of adjustment the economy thrived in the US following the end of WWII, thereby validating Bastiat's argument.

Also, it should be noted that a reverse argument to the demobilization argument applies to forced conscription into military service. People who are drafted into service have an opportunity cost for their time. They may be able to use their time more productively if they were not in service (assuming that the viability of the country was not at stake). That is why the military draft was discontinued and a volunteer army was established after the Vietnam War. In a volunteer army, people must be paid more than the opportunity costs of their time. Consequently, military pay tends to be higher than it would be under a draft and people who judge their time even more highly do not have to serve.

An argument against a volunteer army is that a country may be more susceptible to going to war when the sons and daughters of politicians do not have their lives at risk. Also, a volunteer army may come to view itself as a separate entity from the public and be more likely to revolt or launch a coup against the civilian government. Those arguments are political rather than economic, however.

TAXES

Bastiat noted that some politicians defend taxes by noting that they pay for charitable works and that the beneficiaries of the taxes (including the government officials who collect and administer the taxes) will spend the money on goods and services and, thereby, stimulate the economy. That is seen. What is unseen is what the taxpayers would have done with the money if they had been allowed to keep it and spend it or give it away as they wished. It is not clear that the value of services provided by government equals the value of goods and services that would be produced and consumed in the absence of the tax payments. This is particularly the case in Bastiat's mind because he had previously served on the French government's finance committee. In that role he noted that members of the other party usually argued that government officials should be paid well and enjoy many perks as recompense for providing a service to the government. Bastiat, however, noted that the taxpayer had no choice in deciding whether that service was worth its cost. Further, if the service provided was of no value to the taxpayer, it would be as if the taxpayer had handed his tax money to a thief.

Personal Note: In many of his works, Bastiat equates tax payments to "plunder" as in both cases, a person is forced to give up valuable property without recompense. In my view, the fact of taxation has more effects than just depriving the taxpayer of the ability to spend the money as he or she wishes. There also are disincentive effects to the mere existence of taxes. If a person knows that taxes will be levied upon his or her income, that person may choose to take more leisure or

produce goods for personal consumption that will not generate taxable income or purchases. In addition, in the presence of taxes, a person may choose to avoid taking on risky ventures since the government will levy more taxes if the venture is successful and the person will bear the loss in the event it is not.

PUBLIC WORKS

What is seen are the public works and the labor they employ. In addition, supporters of public works often cite the benefits of the employed workers spending on other goods and services.

However, what is not seen is what the fact that the taxpayers who fund the government projects will have less money to spend elsewhere. Their foregone spending would also have stimulated the economy and provided work to the people who provided their goods.

There may be a question as to whether the value of the public work exceeds the value of goods and services that the taxpayers would have otherwise willingly purchased. If the public would have willingly provided the labor and money to construct the public work, it would be justified. However, some money spent on public works might have been spent foolishly. If the government built a road upon which no one would travel, the taxpayer would "certainly be justified in objecting." If their labor were conscripted to build that road their objections might have some force. However, "money creates an illusion." People may not be aware of exactly how their money is spent once they surrender it to the government, and they might approve of some government financed public works even if they would object to other projects such as foolish road construction.

Personal note: Debt financed public works might lead to less public resistance than forced conscription of labor or forced collection of taxes to finance such works. However, as previously noted when we discussed the broken window fallacy, funds used to buy government debt cannot be used for other purposes, so there will be an opportunity cost to the domestic economy unless the debt is financed by foreigners, who will surrender their personal spending in order to buy our country's debt. Nonetheless, the foreigners will eventually want to be repaid and the domestic economy bequeathed to our children or grandchildren will bear the ultimate opportunity cost. Shortsighted people, remember over two thirds are short sighted, may not worry that much about future opportunity costs borne by future generations.

As a current aside, we now have an administration that is proposing an extensive program for public works. In addition, the administration is engaging in an attempt to reduce our nation's trade deficit. There is potentially a great inconsistency in those policies to the extent that any ensuing government deficit is to be financed by foreigners. The main way that foreigners obtain our money which they use to buy our government debts is by selling us more goods on current account than we buy from them (i.e., through our trade deficit). If we reduce our trade deficit, foreigners will be accruing less money with which to buy our nation's debts.

MIDDLEMEN

Socialists and related schools of thought "are vehement in their attack on those they call middlemen. They would willingly eliminate the capitalist, the banker, the speculator, the entrepreneur, the businessman, and the merchant." They accuse "them of interposing themselves between producer and consumer in order to fleece them both, without giving them anything of value." ... "The sophism of the socialists on this point consists in showing the public what it pays to the middlemen for their services and in concealing what would have to be paid to the state."

Bastiat points out that "the tribute that the people pay to business is what is seen. The tribute that the people would have to pay to the state or its agents in the socialist system is what is not seen." He assumes that the same end product would be rendered by both approaches and then goes on to cite many examples of how (in the event of a famine in Paris) private markets would work to provide goods at the lowest possible price due to self-interest and actual or potential competition among the "middlemen," In contrast, government entities would not be as concerned with obtaining resources and goods efficiently under varying market conditions and might not have the expertise to do so. My paper on "Profits Are Good: Nonprofits Are Questionable" on the Constitutionalist Society website makes many of the same points.

THE RIGHT TO EMPLOYMENT AND THE RIGHT TO PROFIT

In this section of his treatise on what is seen and unseen, Bastiat addresses issues raised in the French Legislature that were intended to provide the unemployed with jobs and to ensure that people could profit from their work. Thus, the socialist parties argued for public workshops to employ the unemployed. He says these policies respond to people who say to society, "You must give me work, and, what is more, lucrative work."

What is seen is the people employed by the public workshops and the work and profit stimulated by the assessments levied upon society. What is not seen is not seen is the work and the profits that would come from the same amount of money if it were left in the hands of the taxpayers themselves. Furthermore, the footnote to Bastiat's treatise notes that the public "workshops proved to be an unsatisfactory solution to the unemployment problem, a farcical system of handouts for little or no work." Thus, eventually, it was decided to abolish the workshops as well as "unemployment places in the army, public works, or private industry." However, the abolition of those sinecures provoked rioting in Paris that was only subdued after fierce fighting.

PERSONAL NOTE: The problem experienced in Paris reflects the fact that some people felt they were entitled to employment and to a good wage regardless of how productive they were. The U.S. is experiencing similar pressures in the form of demands for higher minimum wages and for guaranteed minimum incomes, the latter presumably funded by the government,

Part of the problem with minimum wages and with fixed incomes is that they are subject to "money illusion." Money illusion exists when people focus on the nominal wage or income and do not consider its probable purchasing power. One of the problems in the Great Depression is that prices fell greatly. Thus, it became difficult to employ people at past wages or at wages specified in previous fixed wage contracts since the goods or services they produced could not be sold for as much as they could have been sold previously. This contributed to the unemployment problem at that time because wages were not easily flexible downward.

Minimum wages can also make people unemployable if they are set so high that the value of what a person (often a new or inexperienced person) can produce is worth less than the minimum wage that must be paid, However, as the general level of prices increase, formerly unemployable people will often become employable if the minimum wage does not increase as well. This is the opposite side of money illusion as people who do not notice the price increase do not realize that the purchasing power of the minimum wage has decreased due to the rising price level. As a result, the labor force may increase (as it is doing now) as people opt for work over leisure as wages in general and, possibly, minimum wages as well, increase prior to possible subsequent price increases.

Cyclically, there is a tendency for unemployment rates to fall when nominal wages are rising at a higher rate. This is often called the "Phillips Curve" effect. However, the Phillips Curve is not stable as it mainly reflects the operation of money illusion if wages rise before people

realize that prices are also likely to rise., thereby reducing the future purchasing power of the new higher wages.

Often, when the economy is slack, employers will fight political minimum wage increases as they fear they cannot profitably bear higher production costs. As a result, minimum wages may be stable for a while and if prices increase during that interim, the purchasing power of those wages will be falling so employers will willingly hire more people. As the pool of unemployed people falls, employers may begin to offer more in order to attract employers with the level of potential productivity they need. In such times they may not fight increases in the minimum wage as vigorously since they were planning to pay employees more anyway. They are willing to pay more for employees in general because of rising demand for their products that will result in increased sales and, potentially, increased prices, in the future. However, if the expected price increases do not materialize, employers may have to cut back their employment levels because not as many potential employees will be profitable to hire at the new, higher, minimum wage. Thus, there tends to be a cyclical pattern to political increases in minimum wages. They often are scheduled to increase at times when the economy is strong and prices are potentially going to rise, but if they rise too far, and prices do not rise as much as anticipated, the economy may slow, unemployment may rise, and additional increases in the minimum wage may be deferred.

RESTRAINT OF TRADE

The restraint of international trade can take many forms. I will discuss it in a future paper. Restraint of trade is an old issue and Bastiat addressed it. He posited a case in which a French iron maker wished to use laws to prohibit the import of cheaper Belgium iron. The iron maker argued that if competitive imports were prohibited, he could raise his price and employ more people who would, in turn, spend their increased income to buy more products and stimulate the French economy. That is what would be seen.

What was not seen is the "injustices" that would be done. Other producers who used iron to make their products would find that their costs had increased and their profits would be reduced. They likely would raise their prices and reduce their employment of workers. In addition, to the extent that they raised their prices, people who used their goods would pay more and thus would have less money with which to buy other goods. Therefore, other producers, and their employees, would likely suffer as well. The moral is that using the force of law in the proposed way would not `be to produce but to "destroy."

The restraint of trade that Bastiat discussed involved the prohibition of imports of a certain type. Other types of trade restriction also would have the effect of raising domestic prices and distorting domestic production and employment levels. In general, price increases caused by trade restrictions would make domestic citizens, overall, worse off than before.

Types of trade restriction that I will discuss in the future include:

1. **Prohibitions against imports—such as foreign pharmaceuticals**
2. **Quotas---such as sugar quotas—that limit the quantity of imports-**
3. **Tariffs—such as steel tariffs—under World Trade Organization (WTO) rules, tariffs may be justified to offset "dumping" of products below cost to achieve "predatory pricing"**
4. **Non-tariff barriers—such as required product specifications or inspection routines**

5.Value-Added Taxes or Border Taxes—levied on imports, rebated on exports

6. Exchange Rate Manipulation—to change the foreign currency value of import and exports versus domestic goods and services by changing the relative currency value of the domestic currency versus foreign currencies.